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# ANALYSIS

## ESTABLISHING FACTUAL AND LEGAL CAUSATION IN A FIDUCIARY'S LIABILITY TO ACCOUNT FOR PROFITS



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*The fiduciary doctrine holds that a fiduciary must avoid a conflict of duty and personal interest and must not derive any profit from his fiduciary position. Liability for breach attracts the more extensive remedies of equity's armoury, including the gain-stripping remedy of an account of profits. With respect to a fiduciary's liability to account, although Hong Kong courts recognise that a causal connection between a breach and its ensuing gain is required, there have so far been scant judicial remarks on this front. This article argues that issues of causation and remoteness in the award of an account of profits for a breach of fiduciary duty can be determined by a two-stage inquiry. First, this article examines the possible approaches to establishing factual causation and suggests that a probabilistic approach to causation may be a better way forward. The answer to the second inquiry depends on the nature and purposes of the equitable principles involved.*

### Introduction

The development of a concept of causation has always been more vibrant at law rather than in equity. It has always been a constituent element of liability to establish some causal relationships between a wrongdoing (such as breach of contract or commission of a tort) and its consequence at common law. The position was, until very recently, less clear in equity. The availability of more extensive gain-stripping remedies in equity for a breach of fiduciary duty further muddled the water. Not only does a defaulting fiduciary's liability to account not depend on the beneficiary having suffered any loss, it also appears that once an unauthorised profit is made following a breach of fiduciary duty, causation is taken to have been proven.

Recently, there have been more active judicial excursions in Hong Kong into whether, in a claim for an account of profits following a breach of fiduciary duty, it is necessary to demonstrate that the fiduciary's breach was a cause of the ensuing gain. This article first reviews these recent developments to see

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how Hong Kong courts perceive the role of causation in a fiduciary's liability to account. It is suggested that the issue of "causation" in the award of an account of profits for breach of fiduciary duty can be determined by a two-stage inquiry. The first pertains to the finding of whether the fiduciary's breach, as a matter of fact, produced the gain. The possible causative tests that may be adopted for this factual finding will be considered. It is argued that given the nature and objective of fiduciary principles, in particular the function of fiduciary loyalty to guard against risk of exposing the beneficiary to harm, a probabilistic approach to establishing factual causation can be justified. The second stage deals with what legal consequences the law should attach to the fiduciary's breach. In other words, whether his breach was a legal or proximate cause. It is suggested that the answer depends on the proper scope of liability of the relevant equitable principles.

### Causation, Remoteness and Account of Profits for Breach of Fiduciary Duty

#### *Causation and Fiduciary Loyalty*

The classic exposition of the content of fiduciary loyalty is that a fiduciary must avoid a conflict of duty and personal interest and must not derive any profit from their fiduciary position.<sup>1</sup> These rules were rooted in the recognition of human fragility: fiduciaries, like every other ordinary person, may succumb to the temptation of self-interest whenever circumstances are expedient for them to do so. Because of the need to remove such temptation in order to ensure fiduciary loyalty, a claim may be made to strip any gain reaped by a defaulting fiduciary.

It has been suggested that the strictness of the fiduciary rules means that causation is irrelevant in quantifying the extent of a fiduciary's liability to account: once an unauthorised profit is made following a breach of fiduciary duty, causation is taken to have been proven. For example, in *Murad v Al-Saraj*,<sup>2</sup> the English Court of Appeal held that there was no causation dimension in an account of profits for breach of fiduciary duty and the defaulting fiduciary was strictly liable for all the unauthorised gains.<sup>3</sup> Commenting on the case, Vann defends the decision on the ground that the existence of an unauthorised

<sup>1</sup> See, for example, *Bray v Ford* [1986] AC 44 (HL); *Boardman v Phipps* [1967] 2 AC 46 (HL); *Chan v Zacharia* (1984) 154 CLR 178 (HCA).

<sup>2</sup> [2005] EWCA Civ 959, [2005] WTLR 1573 (CA).

<sup>3</sup> *Ibid.*, at para 67: "... it is no defence for a fiduciary to say that he would have made the profit even if there had been no breach of fiduciary duty" (Arden LJ). See also *Gwembe Valley Development Co Ltd v Koshy (No 3)* [2004] 1 BCLC 131 (CA) at paras 145–147.

profit in the context of a fiduciary breach suggests that the fiduciary has been disloyal, irrespective of whether part of the profit *might* have been authorised by the beneficiary upon full disclosure. In order to achieve best approximation of loyal performance of the no-profit obligation, all unauthorised profit must be disgorged.<sup>4</sup>

The view that causation is irrelevant also appears to have stemmed from the development of equitable concepts. Equity has traditionally been more adamant in providing full relief to plaintiffs. As a result, liability of the defaulting fiduciary is of a more absolute nature. This means that the element of “causation” was formulated far less strictly or even regarded as irrelevant in quantifying fiduciary gains. Arguably, all that is necessary to establish causation is a causal connection between the defaulting fiduciary’s *position* and their profit. For example, the trustee in *Keech v Sandford*<sup>5</sup> would not have been in a position to renew the lease for himself had he not been trustee; and the directors in *Regal (Hastings) Ltd v Gulliver*<sup>6</sup> would not have been in a position to subscribe for the shares had they not been directors.

Thus, profits made in consequence of such positions were held to be sufficient for liability to arise. Properly understood, however, this only suggests that the defaulting fiduciary was required to surrender his gain even though it had not come at the beneficiary’s expense.<sup>7</sup> Besides, cases like *Keech v Sandford* and *Regal (Hastings)* did not expressly address the question of the relevance or otherwise of causation and so should not be taken to have denied a causal inquiry between the fiduciary’s breach and their gain. In quantifying fiduciary gains, there is still a causal inquiry between the fiduciary’s breach and *his* gain to be satisfied. This has been recognised by two recent Hong Kong cases.

In *Kao Lee & Yip v Koo Hoi Yan and Others*,<sup>8</sup> the defendant solicitors set up a new firm whilst still working for their existing employers and subsequently diverted business to their new firm. Ma J held that the defendants breached the fiduciary duties owed to their employers. But in order to disgorge the unauthorised profits obtained from the diversion of a maturing business

<sup>4</sup> Vicki Vann, “Causation and Breach of Fiduciary Duty” [2006] *Sing JLS* 86 at 95, 98. Cf Rebecca Lee, “Causation and Account of Profits for Breach of Fiduciary Duty” [2006] *Sing JLS* (forthcoming).

<sup>5</sup> (1726) Sel Cas Ch 61.

<sup>6</sup> [1967] 2 AC 134 (HL) (hereafter referred to as *Regal (Hastings)*). See also John Glover, *Equity, Restitution and Fraud* (Australia: LexisNexis Butterworths, 2004) at 202: “A nexus must exist between profits made by fiduciaries and their fiduciary offices. Profits made ‘by reason or by use of’ fiduciary offices involve the *exploitation* of that office that the rule requires”.

<sup>7</sup> See, for example, *Attorney General v Blake* [2001] 1 AC 268 (HL) at 280H where Lord Nicholls held that trustees and fiduciaries must disgorge any unauthorised profit irrespective of any loss suffered by the beneficiaries. See also *Keech v Sandford*, n 5 above, where the trustee was required to disgorge the gains even though the beneficiary could not have obtained the lease himself.

<sup>8</sup> [2003] 3 HKLRD 296 (CFI) (hereafter referred to as *Kao Lee & Yip*).

opportunity, there had to be a causal link between the opportunity and the profits made. In deciding the extent of the account, it was necessary to focus on causation and remoteness when examining the link between the breach and the gain:

“... [when ordering an account of profits,] the approach must be to take into account various factors relevant to the critical inquiry (namely, what is the gain that the fiduciary has made as a result of his breach of fiduciary duty?)”<sup>9</sup>

“... when dealing with an account of profits as regards business opportunities, the Court’s approach must necessarily be flexible. The key is to remember at all times the critical inquiry referred to above which emphasises to need to focus on causation and remoteness when examining the link between the breach of duty and the gain.”<sup>10</sup>

More recently, a causal inquiry between the breach and the gain has also been implicitly recognised by the Court of Final Appeal. In *Tripole Trading Ltd v Prosperfield Ventures Ltd*,<sup>11</sup> the company directors breached their fiduciary duty by attempting to enter into agreements to misappropriate certain shares of their company’s subsidiary. Although the impugned agreements were not carried into effect, the defaulting directors were subsequently allocated substantial shares after a restructuring exercise carried out by the Shenzhen Government. In deciding whether causation provided a possible alternative basis for liability of the directors, the Court rejected the decisions of the lower courts that the agreements entered into in breach of fiduciary duty provided the causal link with the Shenzhen Government’s allocation of shares. To them, there were other plausible reasons for the allocation of shares, and the trial judge’s conclusion that the defaulting directors’ breach enabled the Government to allocate shares to them was “wide of the mark”.<sup>12</sup> Despite the Court of Final Appeal’s denial of the directors’ liability, this case indicates that all levels of courts in Hong Kong recognised the need to find some causal relationships between the breach and the gain; proof of such a causal link only failed on the facts before the Court of Final Appeal. Indeed, the need to show some causal connections between the breach and the gain has also been accepted by some other Commonwealth

<sup>9</sup> *Ibid.*, at 339.

<sup>10</sup> *Ibid.*, at 340.

<sup>11</sup> [2006] HKEC 14, [2006] 1 HKLRD 200 (CFA) (hereafter referred to as *Tripole*).

<sup>12</sup> *Ibid.*, at para 66.

jurisdictions.<sup>13</sup> Besides, in other areas of law where an account of profits is sought, there has been little dispute that proof of a causal connection is essential.<sup>14</sup>

This brief overview shows that courts have already shown a willingness to endorse some causal connections between a breach and its ensuing gain. One of the greatest objections to disgorgement of fiduciary gains is that, in one sense, disgorgement may be said to result in a windfall for the beneficiary.<sup>15</sup> This concern is conventionally addressed by justifying the remedy on policy grounds: it is essential to maintain a high standard of loyalty to ensure that fiduciaries are financially disinterested in the discharge of their duties.<sup>16</sup> However, from a causal perspective, it is submitted that it is also plausible to address this concern at a more pragmatic level by fine-tuning the remedy: there should be limits to the order of an account of profits so that the defaulting fiduciary is only accountable for those profits causally relevant to the breach. This suggests application of principles of causation and remoteness. But before attempting to grapple with the logical question that ensues, namely *what* tests of causation and remoteness should be adopted in establishing fiduciary's liability to account, a few comments on the proper causal inquiry are in order.

#### *Causation: a two-stage inquiry*

To start with, it is necessary to see how causation functions in delineating the scope of relief for a breach of fiduciary duty. "Causation" is often used in a loose sense. In fact, there are two stages to any causal inquiry.<sup>17</sup> The first stage identifies causes or, more precisely, "causally relevant conditions" by an investigation and ascertainment of facts, and is regarded as establishing *factual* causation. The law, however, does not treat all causally relevant conditions as legally significant. Thus, there is a second stage pertaining to the scope of legal responsibility that allows values and policies to be elucidated before

<sup>13</sup> See, for example, *Say-Dee Pty Ltd v Farah Constructions Pty Ltd* [2005] NSWCA 309 where the New South Wales Court of Appeal held that there was a causal link between the defendant's acquisition of material information in the course of performing its fiduciary duties and the benefits derived from his subsequent exploitation of the opportunity himself. The defendant was required to disgorge the benefits derived from its breach. Note that the High Court of Australia heard the appeal of the case in December 2006. See also *Canada Inc v Strother* (2005) 38 BCLR (4th) 159 (BCCA).

<sup>14</sup> For example, in a claim for patent infringement, the court held in *Celanese International Corp v BP Chemicals Ltd* [1999] RPC 203 (Patents Court) at para 37 that: "In an account the court is trying to determine what profits have been caused, in a legal sense, by those acts".

<sup>15</sup> This is particularly so when the commercial reality was that the beneficiary could not have reaped the profit himself, as in *Boardman v Phipps* (n 1 above).

<sup>16</sup> *Attorney General v Blake* (n 7 above) at 280G.

<sup>17</sup> Antony Honoré, "Causation in the Law", in Edward N. Zalta (ed), *The Stanford Encyclopaedia of Philosophy* (Winter 2005 Edition), available at <http://plato.stanford.edu/archives/win2005/entries/causation-law/> (visited 17 October 2006). Alternatively, Professor Weinrib suggested that there are two meanings of the word "cause": Ernest J. Weinrib, "A Step Forward in Factual Causation" (1975) 38 MLR 518.

legal responsibility is attributed. The causally relevant condition to which legal responsibility is to be attributed is regarded as the *legal* or proximate cause. Professors Hart and Honoré believed that the two stages should not be amalgamated.<sup>18</sup> This dichotomy has also been judicially recognised.<sup>19</sup>

This two-stage process shows that a causal inquiry concerns the proper allocation of legal responsibility for an outcome following certain conduct. In determining an appropriate causative test, the policy reasons underlying a particular area of law have to be taken into account. However, once an appropriate causative test is determined, the application of this test to ascertain the existence of a causal relationship between the breach and the outcome remains a question of fact.<sup>20</sup> This article first deals with the determination of an appropriate causative test in establishing factual causation (causal responsibility) in an account of profits following a breach of fiduciary duty. There follows a brief discussion of the answer to the second stage of the inquiry, namely whether legal responsibility should be attributed to the causally relevant condition(s) identified. As will be seen, this is influenced by factors such as policy concerns of a particular legal rule.<sup>21</sup>

### Establishing Factual Causation in a Fiduciary's Liability to Account

#### *Current approaches to factual causation*

There are two prominent approaches in the contemporary analyses of causal responsibility which may be adapted to establishing causation in a fiduciary's liability to account. Each will be examined in turn.

<sup>18</sup> H. L. A. Hart and Tony Honoré, *Causation in the Law* (Oxford: Clarendon Press, 2nd edn 1985), p lii. Note that the question of factual causation precedes legal causation: Glanville Williams, "Causation in the Law" (1961) *CLJ* 62 at 69.

<sup>19</sup> See, for example, McHugh JA in *Alexander v Cambridge Credit Corp* (1987) 9 NSWLR 310 at 350: "... the common law is concerned with whether on a particular occasion a particular act or omission contributed to the occurrence of a particular event (causation) and, if so, with whether responsibility should attach to that act or omission (remoteness)." (emphasis in original). Cf *BNZ v Guardian Trust* [1999] 1 NZLR 213 at 240 (Fisher J).

<sup>20</sup> A legal system would decide whether causing harm is an element of legal responsibility, and once this is decided, the question of whether the defendant's act was a cause of the harm would be a question of fact, rather than a question of policy: see Hart and Honoré, n 18 above at 91–92. It should be noted that although policy considerations should only come into play at the second stage of the inquiry, it does not follow that the process of determining an appropriate causative test (as opposed to applying the predetermined causative test) need also be value-free.

<sup>21</sup> Some commentators – known as "causal minimalists" – consider the issue of remoteness to be entirely an issue of legal policy. Note that Hart and Honoré adopted a broader approach that while the issue of remoteness is partly dictated by policy considerations, issues of factual causation may also come into place. This is because when the court holds that the damage is remote, the ordinary man would regard causation as not being established.

### 1. "But for" causation

Under the "but for" test, A is a causally relevant condition of B if and only if B would not have occurred in the absence of the occurrence of A. Applying the "but for" test, in order to prove that the breach is a causally relevant condition of the gain, the beneficiary must prove that the fiduciary would not have made a gain for which disgorgement is claimed in the absence of the fiduciary's breach. The "but for" test thus serves an exclusionary function in that it enables us to eliminate irrelevant events. Although the "but for" test is thought to be generally applied to common law claims (eg breach of contract or commission of a tort<sup>22</sup>), it has also received judicial approval in equity. For example, in the context of a claim for equitable compensation for a breach of fiduciary duty, the English Court of Appeal in *Swindle v Harrison*<sup>23</sup> adopted a "but for" test to hold that Mrs Harrison failed to show that the material non-disclosure of her solicitor was a *necessary* constituent for her loss: such necessity was precluded on the finding of facts.<sup>24</sup>

Despite prevalence of the "but for" test, it has also been shown to be inadequate. First of all, causation asks what *did* happen. But instead of assessing the defendant's conduct directly, the "but for" test asks whether the outcome *would or might have been* the same had things been otherwise. This situation is *ex hypothesi* non-existent,<sup>25</sup> and thus answers for such counterfactual inquiries are inevitably conjectural. Although in the run-of-the-mill cases, the two questions (namely what happened and whether the outcome would or might have been the same respectively) will produce the same answer, the "but for" test fails to ascertain the causally relevant condition in cases of potential multiple causes.<sup>26</sup> A classic example can be found in the tort case of *Summers v Tice*.<sup>27</sup> The victim who was shot by two negligent hunters at the same time could not prove which of them actually injured him under the "but for" test. There is little doubt that both hunters were equally morally culpable, and each should be described as a cause of the victim's injury, yet the "but for" test

<sup>22</sup> In tort claims, for example, the "but for" test suggests that the tortfeasor's conduct is a cause of the defendant's injuries if and only if, had the tortfeasor not acted tortiously, the defendant would not have been injured. The tortfeasor's conduct need only be a cause of the defendant's injury.

<sup>23</sup> [1997] 4 All ER 705 (CA).

<sup>24</sup> It was found that Mrs Harrison would have taken up the loan to finance her hotel transaction anyway even if there had been full disclosure by her solicitor that his firm was making a profit from the loan transaction. Evans LJ quoted at 732f-g the trial judge's opinion that: "... It was, after all, a lifeline for [Mrs Harrison]. There is no evidence that a better offer could have been obtained elsewhere ... Realistically, she had no choice". Rather, the loss flowed from her own decision to take the risk involved in the hotel transaction: Mummery LJ at 735c.

<sup>25</sup> Weinrib, n 17 above at 522.

<sup>26</sup> This is known as the problem of over-determination.

<sup>27</sup> 33 Cal 2d 80, 199 P2d 1 (1948).



fails to identify either of them as the wrongdoer.<sup>28</sup> In a similar vein, a “but for” causal link was also denied in the Court of Final Appeal case of *Tripole*: the directors’ breach of fiduciary duty (by attempting to misappropriate certain shares under the impugned agreements) was not a necessary condition of the gain because, in its absence, the Court suggested that they might still have been allocated the shares by the Shenzhen Government due to other plausible reasons.<sup>29</sup>

## 2. Common sense approach to causation

Besides the “but for” test, another possibility would be to apply a common sense approach to establishing factual causation in an account of profits for a breach of fiduciary duty. This approach has been gaining favour recently, albeit in claims for equitable compensation. This view was propounded by McLachlin J in *Canson Enterprises Ltd v Boughton & Co.*<sup>30</sup> There, Canson sought equitable compensation for their solicitor’s breach of fiduciary duty by failing to disclose to them material information relating to their property transaction. It was found that Canson would not have proceeded with the joint venture had they known the true facts. McLachlin J, in delivering a separate concurring judgment, thought that applying a strict “but for” test would clearly result in the solicitor being held liable even for losses caused subsequently by the negligence of third party engineers and builders. Her Ladyship therefore added a limitation to make those losses not recoverable as follows:

“... it is essential that the losses made good are only those which, on a *common sense view of causation*, were caused by the breach.”<sup>31</sup>

McLachlin J’s minority judgment was subsequently endorsed by the House of Lords in *Target Holdings (Ltd) v Redferns*.<sup>32</sup> However, despite it being couched

<sup>28</sup> Or the “but for” test would fortuitously assign responsibility to the one whose shot was found to have hit the victim, but not the other who missed him, even the moral wrongdoing of both was equivalent: Judith Jarvis Thomson, *Rights, Restitution, and Risk* (Cambridge: Harvard University Press, 1986), Ch 12. Hart and Honoré also noted the difficulty in such cases, but simply observed that “[i]t is perfectly intelligible that in these circumstances a legal system should treat each as the cause rather than neither, as the *sine qua non* test would require”: Hart and Honoré, n 18 above at 124. In view of the inadequacies of the “but for” test, a NESS test has been introduced to deal with situations where there are multiple sufficient causes. Under the NESS test, an act or omission is a cause if it is a necessary element of a set of factors sufficient for the harm to occur: see Richard Wright, “Causation in Tort Law” (1985) 73 *California Law Review* 1735.

<sup>29</sup> *Tripole* (n 11 above). The brief facts of this case are set out in text accompanying nn 11–12 above. Note that the Court of Final Appeal did not canvass the question of whether the impugned agreements would have influenced the government allocation of shares.

<sup>30</sup> (1991) 85 DLR (4th) 129 (SCC) (hereafter referred to as *Canson Enterprises*).

<sup>31</sup> *Ibid.*, at 163 (emphasis added).

<sup>32</sup> [1996] AC 421 (HL) at 439 (Lord Browne-Wilkinson) (hereafter referred to as *Target Holdings*). The case was referred to by the Court of First Instance in *Man Fong Hang v Man Ping Nam & Others* [2003] HKEC 1475 (CFI).

in terms of “causation” rather than “remoteness”, it appears that this “common sense view of causation” acts only as a remoteness rule in attributing legal responsibility, rather than being applied additionally as a causative test in determining causal responsibility.<sup>33</sup>

Nonetheless, the common sense test has seemingly assumed the additional role of establishing factual causation: whenever the “but for” causative test produces an unjust result, a more pragmatic common sense approach would be preferred.<sup>34</sup> Adopting a “common sense” causative test undeniably has the merit of dispensing with the need to prove necessity of the alleged causally relevant condition for the gain and thus in effect lowering the threshold for establishing factual causation. Yet a few objections to the “common sense” test can also be raised: First, since McLachlin J presupposed that rules of remoteness are irrelevant,<sup>35</sup> the common sense test may be deluged with the function of attributing legal responsibility fairly.<sup>36</sup> As discussed above,<sup>37</sup> there are two stages of a causal inquiry, namely (first) identifying causally relevant conditions and (second) attributing legal responsibility. The task of the causative test pertains to the first stage only. It is not necessary to introduce one single test to confuse the different objects of the two stages of the inquiry.<sup>38</sup> Second, given Hong Kong courts have already accepted that remoteness is a relevant consideration in quantifying the extent of an account of profits,<sup>39</sup> it is unnecessary to resort to a test which merges causation and remoteness. Last but not least, the concept of “common sense” may itself be criticised for being vague and unstable.

<sup>33</sup> The remoteness rule is a causal limiting factor that severs the *causal* tie between the breach and the gain. For example, Blackburne J opined in *Nationwide Building Society v Balmer Radmore* [1999] Lloyd's Rep PN 241 at 282 that the loss following the breach of the fiduciary duty in *Canson Enterprises* was “too remote for the breach to be said to be a loss flowing from it”. Further, reading her Ladyship's statement in context, McLachlin J was rejecting the common law principle of foreseeability as a limiting factor in propounding a “common sense” rule for equity, though it was unclear whether her Ladyship intended this “common sense” limiting factor to perform the function of a “but for” causative test simultaneously.

<sup>34</sup> As in *Canson Enterprises* (n 30 above). Further, Lord Browne-Wilkinson in *Target Holdings* (n 32 above) has been criticised for not differentiating between establishing factual causation and attributing legal responsibility: Richard Nolan, “A Targeted Degree of Liability” [1996] LMCLQ 161 at 163.

<sup>35</sup> For example, McLachlin J stated in *Canson Enterprises*, n 30 above that “. . . foreseeability of loss does not enter into the calculation of compensation for breach of fiduciary duty” (at 160) and “[f]oreseeability is not a concern in assessing compensation” (at 163). Both statements were endorsed by Lord Browne-Wilkinson in *Target Holdings*, n 32 above at 438.

<sup>36</sup> Alternatively, courts might have simply repackaged attribution of legal responsibility in terms of causation rather than remoteness, as the English Court of Appeal did in *Swindle v Harrison* (n 23 above) when rejecting the relevance of remoteness yet emphasising the common sense causal link between the breach and the loss: Lusina Ho, “Breach of Fiduciary Duty and Causal Responsibility” (1997) 11 *Trust Law International* 72 at 75.

<sup>37</sup> For an explanation of the two-stage causal inquiry, see text accompanying nn 17–21 above.

<sup>38</sup> Otherwise, the single test may, for example, fail to undertake an open examination of all the relevant policy considerations in attributing legal responsibility, a role which is assumed by the second stage of the inquiry.

<sup>39</sup> See, for example, *Kao, Lee and Yip* (n 8 above).

In light of these objections, it is submitted that adoption and endorsement of the common sense approach at best shows that courts appreciate the inadequacies of the “but for” test and the need to adopt a less restrictive causative test. If so, it is submitted that a different approach based on probabilistic causation may be considered as an attempt to formalise the inherently nebulous “common sense” approach.

### Probabilistic Causation for Fiduciary’s Liability to Account

#### *Definition of probabilistic causation*

The central idea is that causes raise the probability of their effects. If the occurrence of *A* increases the probability of *B* more than if *A* does not exist, then *A* raises the probability of *B*. Since *B* occurs at higher rates if *A* exists than if it (*A*) does not, under a probabilistic causation approach, this is *prima facie* evidence that *A* can be regarded as the cause of *B*.<sup>40</sup>

The probabilistic causation approach differs from the “but for” test in a number of respects. First, the “but for” test requires proof of necessity of the alleged breach. Expressing the “but for” test in terms of probability, the probability of *B* occurring without the occurrence of *A* is zero. The “but for” test is therefore akin to an all-or-nothing test.<sup>41</sup> Under a probabilistic approach, however, we are assessing the probability of various events, and whether the probability of one event is increased because of some others. Thus, in the context of a fiduciary’s liability to account, so long as the alleged breach of fiduciary duty is a significant factor contributing to the increase in the probability of the occurrence of the ensuing gain, factual causation can be established.<sup>42</sup> This represents refinement (extension) of the “but for” test. Second, contrary to the “but for” test which attempts to look backward by making counterfactual inquiries,<sup>43</sup> the probabilistic approach represents more of an anticipatory determination of causally relevant conditions. One may

<sup>40</sup> See further, Ernest Sosa and Michael Tooley (eds), *Causation* (Oxford: OUP, 1993) at 19–22 and the references cited therein.

<sup>41</sup> The causative test (“but for” or otherwise) relates to the *quality* of an alleged event required in proving causation between that event and the outcome. The “but for” test requires the event to be an essential ingredient (hence akin to an all-or-nothing test) of the outcome; whereas the probabilistic approach requires it to be a probabilistic element only. Whatever causative test is adopted, this is different and separate from the question of civil burden of proof, which requires the elements constituting the claim to be *made out* on a balance of probabilities.

<sup>42</sup> For example, applying this test to *Tripole* (n 11 above), although the Court rejected the view that the defaulting directors’ breach of fiduciary duty was necessary for the government allocation of shares, if the probability of government allocation of shares given the occurrence of the breach was greater than the probability of allocation without the breach, this increased probability could amount to a causally relevant condition of the gain under a probabilistic causation approach.

<sup>43</sup> See text accompanying n 27 above.

focus on the defaulting fiduciary's breach and then look forward to see if a causal connection can be found between the breach and the gain.<sup>44</sup>

Although a probabilistic approach to causation may seem novel, it has in fact been endorsed by the English House of Lords. There is an emerging exception in the tort of negligence to deal with situations where it is extremely difficult to establish a causal link between a defendant's wrongdoing and a plaintiff's injury because of the existence of multiple defendants or the occurrence of multiple events leading to the injury. In such circumstances, the standard "but for" test may be unworkable, but causation can still be established on the basis that the defendant's negligence "materially contributed" to the risk of occurrence of the injury. In *Fairchild v Glenhaven Funeral Services Ltd and Others*,<sup>45</sup> the workers contracted mesothelioma through the negligence of the defendant employers who exposed them to asbestos dust. However, it could not be known *which* of the negligent employers had caused the disease as the workers had worked during various periods of employment with more than one of the employers. All that the workers could show was a substantial possibility that the asbestos had some connections with their disease. The House of Lords held that in such circumstances (ie multiple causes, each of which is independently capable of producing the injury), proof that each defendant's wrongdoing had materially increased the risk of contracting the disease was sufficient to satisfy the causal requirements for his liability.<sup>46</sup> As a result, each of the employers was held liable.

If this analysis is adopted, then a defendant held liable under the *Fairchild* principle should only be severally liable to the extent that he has increased the risk of the plaintiff's injury.<sup>47</sup> This indeed was the decision of a subsequent House of Lords case – *Barker v Corus (UK) plc* – which held that a defendant was entitled to an apportionment of liability measured with reference to his contribution to the risk of injury.<sup>48</sup> If liability is to be established on

<sup>44</sup> Admittedly, in law an assessment, based on the particular evidence, of the probability that an agent caused the outcome in question is an *ex post* assessment.

<sup>45</sup> [2002] UKHL 22, [2003] 1 AC 32 (HL) (hereafter referred to as *Fairchild*). See also *McGhee v National Coal Board* [1973] 1 WLR 1 (HL).

<sup>46</sup> *Fairchild*, *ibid.*, at para 34 (Lord Bingham); para 47 (Lord Nicholls); paras 65–67 (Lord Hoffmann); para 116 (Lord Hutton) and paras 168–170 (Lord Rodger). A departure from the standard "but for" test is permissible only when certain conditions are satisfied: para 2 (Lord Bingham); para 61 (Lord Hoffmann) and para 170 (Lord Rodger) and where justice so requires: para 9 and paras 32–33 (Lord Bingham). Further, this is similar to the substantial factor test which has been adopted in the context of negligence and a number of other torts by the US Restatement (Second) of Torts, para 432 (1965). Contra the decision of the Supreme Court of Canada in *Athey v Leonati* (1996) 140 DLR (4th) 235 where a purely probabilistic approach was rejected.

<sup>47</sup> See Sarah Green, "Winner Takes All" (2004) 120 LQR 566 at 570.

<sup>48</sup> [2006] UKHL 20, [2006] 2 WLR 1027 at para 43 (Lord Hoffmann). See also the US Restatement (Second) of Torts, para 433A (1965): "(1) Damages for harm for to be apportioned among two or more causes where (a) there are distinct harms, or (b) there is a reasonable basis for determining the contribution of each cause to a single harm"

probabilistic causation, one may query how significant a cause has to be in order to qualify as a factual cause. The concern behind this query appears to be the potential unfairness in assigning full causal responsibility to an event where absolute proof is necessarily unattainable. While it may be unfair to treat as certain a cause which has only a significant contribution to the result, *Barker v Corus (UK) plc* opens the possibility of adjusting the award to reflect the degree of probability contributed by an event.<sup>49</sup>

With the recent developments of causation in the law of tort, similar strides in the equity jurisprudence may be expected. It is submitted that a probabilistic causation approach to quantifying fiduciary gains would also be consistent with the developments of the concept of causation in equity as well as the objective of fiduciary law.

*Developments of the concept of causation in equity*

Although Hong Kong courts have recently recognised that a causal inquiry between the breach and the gain is required,<sup>50</sup> taking the historical development of causation in a fiduciary's liability to account into consideration, it is not difficult to discern that equity only requires a beneficiary to satisfy a low causal threshold in order to hold a defaulting fiduciary accountable for their gains.<sup>51</sup> A probabilistic approach to causation sits comfortably with the equity jurisprudence. While requiring proof of "but for" necessity in establishing factual causation would fall on one end of the causality spectrum and dismissing any requirement of causality on the other, a probabilistic approach represents a compromised solution between these ends. It establishes a causal connection when there is an increase in probability of an outcome (gain) by the occurrence of an event (breach). Its broader net of recovery arguably aligns most closely with the conventional understanding that a low causal threshold is all that is called for in quantifying fiduciary gains.

*Objective of fiduciary law as alleviating risk of exposure to unauthorised gains*

Furthermore, it is submitted that a probabilistic approach to causation is consistent with the objective of fiduciary law. A fiduciary relationship exists when one voluntarily assumes a duty to act solely in the interests of another, and is delegated discretion which can be exercised to (adversely) affect the position

<sup>49</sup> Besides, the concern can also be addressed at the second stage of the causal inquiry. A remoteness rule can be recognised and invoked where appropriate. See further, the section on "Establishing Legal or Proximate Causation in Fiduciary's Liability to Account" below.

<sup>50</sup> See text accompanying nn 8–12 above.

<sup>51</sup> See text accompanying nn 5–6 above.

of the latter.<sup>52</sup> The position of the fiduciary may also be such that they have exclusive access to information that is not generally available. The beneficiary's interests may thus easily be prejudiced not only because the circumstances make it expedient for the fiduciary to advance their own self-interest, but also because scrutiny of the fiduciary's exercise of discretion is very costly, if not impossible.

One of the objectives of fiduciary law is, then, to reduce the beneficiary's risk of exposure to the harm<sup>53</sup> of their interests being prejudiced by deterring the fiduciary from using their discretion save for the benefit of the beneficiary. This can be achieved by means of imposing a fiduciary obligation of loyalty to enhance the fiduciary's performance of their primary duty.<sup>54</sup> That an objective of fiduciary law is to prevent risk of exposure to harm can be illustrated by the following examples.

First, in a claim for breach of either of the no-conflict and no-profit fiduciary rules, liability may arise even there was no *actual* "damage" or loss suffered by the beneficiaries. This reinforces the objective of fiduciary law to protect the beneficiary from risks of exposing to harm. The policy of deterrence would hold that risks of unreasonable exposure to harm are sufficient to ground liability. For example, even though the company in *Regal (Hastings)* was unable to take up a business opportunity, the defendant directors who later took it up were held to be liable. Although the circumstances were arguably such that no actual damage could have been suffered by the company in the first place, Lord Russell nonetheless famously remarked that it was irrelevant whether the profit "would or should otherwise have gone to the [company]".<sup>55</sup>

Second, a beneficiary may invalidate a transaction so long as they show that the fiduciary *might* possibly have had the means of taking advantage of the situation. For example, in *Boardman v Phipps*,<sup>56</sup> the beneficiary successfully claimed an account of profits from Boardman, solicitor to the trustees, even though the trust could not have made use of the information and opportunity itself and Boardman who entered into the transaction could not have,

<sup>52</sup> *Hodgkinson v Simms* (1994) 117 DLR (4th) 161 (SCC) (La Forest J). See also Ernest J. Weinrib, "The Fiduciary Obligation" (1975) 25 *University of Toronto Law Journal* 1 at 4.

<sup>53</sup> See, for example, Tamar Frankel, "Fiduciary Law: The Judicial Process and the Duty of Care" in *The 1993 Isaac Pitblado Lectures* (University of Manitoba Law School), 143 at 144–145: "Because the [fiduciary] relationship poses for one party . . . substantial risks of misappropriation and monitoring costs and because public policy strongly supports both groups of services, *fiduciary law interferes to reduce these risks and costs*"; quoted in *Hodgkinson v Simms*, *ibid.*, at 185 (La Forest J) (emphasis added).

<sup>54</sup> Matthew Conaglen, "The Nature and Function of Fiduciary Loyalty" (2005) 119 *LQR* 452.

<sup>55</sup> *Regal (Hastings)*, n 6 above, at 144G. It should, however, be noted that this does not mean that causation is irrelevant. As J. D. Heydon commented in "Causal relationship between a Fiduciary's default and the Principal's loss" (1994) 110 *LQR* 328 at 332 that: ". . . it is one thing to strip a fiduciary of profit without much enquiry; it is another to hold him accountable for all loss without enquiring into relative causes".

<sup>56</sup> See n 1 above.

in the particular circumstances of the case, obtained the consent of all the trustees. A theoretical (rather than real or sensible) possibility of conflict encountered by Boardman – even if it at most amounts to unreasonable exposure of the beneficiary to risk – was held to be sufficient to ground liability.

If one of the objectives of fiduciary law were to deter risks, then liability might well be imposed on the creation of unreasonable risks itself.<sup>57</sup> Probabilistic causation identifies those events which may increase the risk of prejudicing the beneficiary's interests as causally relevant conditions. It performs precisely the role of regulating risks of exposure to harm. Since the function of probabilistic causation coincides with the policy objective of fiduciary law, this approach at least offers a viable alternative to the "but for" test.

### Establishing Legal or Proximate Causation in a Fiduciary's Liability to Account

Once the first inquiry is answered in the affirmative, it is necessary to examine whether the fiduciary's breach is to be considered as a cause of the gain for which legal responsibility is to be attributed. What legal consequences should the law attach to the fiduciary's breach? At common law, this is traditionally addressed with reference to a rule of remoteness. In equity, although there are suggestions that considerations of foreseeability or remoteness do not operate to delimit the scope of liability (for equitable compensation) for breach of fiduciary duty,<sup>58</sup> the most prevalent formulation appears to have invoked "common sense" notions<sup>59</sup> to answer this inquiry. It is submitted that in order that the gain is not too "remote", the account must be within the scope of liability for breach of fiduciary duty.<sup>60</sup> But this must be read together with the caveat that judges have expressed on the remedy:

<sup>57</sup> Besides, that equity is concerned with risk aversion is not uncommon. For example, an injunction may be granted against a former principal to prevent a real risk of disclosure of confidential information of a former client: *Prince Jefri Bolkiah v KPMG* [1999] 2 AC 222 (HL); *Koch Shipping Inc v Richards Butler* [2002] EWCA Civ 1280, [2002] 2 All ER (Comm) 957 (CA).

<sup>58</sup> *Re Dawson* [1966] NSW 211 at 214–215; *Bank of New Zealand v New Zealand Guardian Trust Co Ltd* [1999] 1 NZLR 664 (NZCA) at 687 (Tipping J). Contra Steven Elliott, "Remoteness Criteria in Equity" (2002) 65 MLR 588.

<sup>59</sup> *Canson Enterprises* (n 30 above). Yet as discussed above, the concept itself is vague. A number of suggestions have been made to refine this approach. See, for example, Lusina Ho, "Attributing losses to a breach of fiduciary duty" (1998) 12 *Trust Law International* 66; Charles Rickett, "Equitable Compensation: Towards a Blueprint" (2003) Syd LR 3.

<sup>60</sup> *Boardman v Phipps*, n 2 above at 127 (Lord Upjohn); *Warman International Ltd v Dywer* [1994–1995] 182 CLR 544 (HCA) at 560.

“... the liability of the fiduciary should not be transformed into a vehicle for the unjust enrichment of the plaintiff.”<sup>61</sup>

Thus, in *Warman International Ltd v Dwyer*, although Dwyer exploited his principal company's goodwill in setting up his own company, he was only compelled to account for the profits of his business operation to his principal for a limited period of two years to reflect his skill, expertise and other expenses incurred. Likewise, the duty of loyalty requiring a trustee to act in the sole interest of the beneficiary (thus prohibiting any profit to the trustee) has been increasingly challenged.<sup>62</sup> From a causal perspective, this simply acknowledges a remoteness rule in quantifying fiduciary gains. For example, while the decision in *Warman International Ltd v Dwyer* is conventionally explained with reference to the court's exercise of remedial discretion, it could also be understood in terms of part of the profit claimed being too remote or beyond the scope of Dwyer's fiduciary duty<sup>63</sup> and hence legal responsibility was restricted.

#### *Test of remoteness*

At common law, the reasonable foreseeability test is generally adopted. For example, in the tort of negligence, the tortfeasor is liable for the type or kind of damage that was reasonably foreseeable as a result of the tort.<sup>64</sup> In the law of contract, the contract-breaker is liable for the type or kind of damage that was within the reasonable contemplation of the parties at the time of the contract as likely to result from the breach.<sup>65</sup> However, it is possible not to adopt such metaphors in an account of profits, but consider openly the policies involved. Factors such as the nature of the gain or the degree of the defaulting fiduciary's culpability could all be relevant. An example of the former could be found in *Warman International Ltd v Dwyer* where a distinction was drawn between those cases in which a specific asset was acquired by the fiduciary and those in which a business was acquired and operated.<sup>66</sup> As to the

<sup>61</sup> *Warman International Ltd v Dwyer*, *ibid.*, at 561. This has also been applied in a number of Hong Kong cases. See, for example, *Kao Lee and Yip*, n 8 above at para 144; *Wu Shun Kwan v Lam Koon Wan and Another* [2005] HKEC 635 at para 60. Cf claims for equitable compensation where the English Court of Appeal held that liability should be decided by first identifying the scope of the duty breached and the purpose of the rule imposing the duty: *Swindle v Harrison*, n 23 above at 734 (Mummery LJ).

<sup>62</sup> See, for example, John Langbein, "Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?" (2005) 114 *Yale LJ* 929 which argues that the duty of loyalty in trust law should be made less strict.

<sup>63</sup> This was the interpretation adopted by the majority in *Murad v Al-Saraj* (n 2 above).

<sup>64</sup> *Overseas Tankship (UK) Ltd v Morts Docks & Engineering Co Ltd (The Wagon Mound) (No 1)* [1961] AC 388.

<sup>65</sup> *Hadley v Baxendale* (1854) 9 Ex 341, 156 ER 145; *Koufos v C Czarnikow Ltd (The Heron II)* [1969] 1 AC 350.

<sup>66</sup> *Warman International Ltd v Dwyer* (n 60 above) at 561.



latter, in *Gwembe Valley Development Co Ltd v Koshy (No 3)* where the company director made an unauthorised profit by deliberately and dishonestly failing to disclose his personal interests in transactions with the company, Mummery LJ held that it was wrong to limit the scope of his account and that he could not “be heard to say, as against the beneficiary company, that he was entitled to retain any of the profits for himself”.<sup>67</sup> This could be seen as drawing a distinction between an honest and a dishonest breach of fiduciary duty, and that in the circumstances, the egregious nature of the company director’s breach of fiduciary duty denied him of any benefit of a remoteness limitation.<sup>68</sup> Other factors such as whether the defaulting fiduciary should have been aware of the future risks of his actions, or whether risk-taking entrepreneurial activities should be allowed might also be relevant.

While it is impossible to offer any determinative test of remoteness, in deciding how the rule of remoteness should operate, the above analysis at least makes it possible to subject the liability of a defaulting fiduciary to account to an open policy analysis. The use of mere discretionary languages to conceal the proper role of a remoteness rule should be deprecated.

## Conclusion

Causation is of central importance in our understanding of any area of law, but is a topic bewildered with intractable complexity. This article shows how a fiduciary’s liability to account for profits in a breach of fiduciary duty can be determined with reference to a two-stage causal inquiry. In establishing factual causation, the “but for” test is not sacrosanct. Although a probabilistic approach appears novel if not radical, it has been endorsed in some negligence cases in tort. As fiduciary law regulates exposures to risk, adopting a causative test which requires a lower threshold for establishing factual causation is not objectionable. Further, by casting a wider net of recovery over the potentially causally relevant conditions, a probabilistic approach to causation can be justified on the basis that it aligns most closely with the strict prophylactic approach to a fiduciary’s liability to account. Thus, there is much scope for further exploration of the possibility of embracing this approach in equity.

<sup>67</sup> See n 3 above at para 137.

<sup>68</sup> The egregious nature of the company director’s breach of fiduciary duty was emphasised throughout the judgment. Cf the tort of deceit where the tortfeasor’s liability extends to all loss directly flowing from the breach, whether it was reasonably foreseeable or not: *Smith New Court Securities Ltd v Citibank NA* [1997] AC 254 (HL).

Nevertheless, establishing factual causation in a fiduciary's liability to account is only the first stage of a causal inquiry. A causal inquiry involves two analytically distinct stages. Any concern regarding potential windfall of the beneficiary resulting from disgorgement of fiduciary gains can further be properly alleviated at the (second) stage of attributing legal responsibility. Here, the question of legal causation is at least to some degree an issue of legal policy, such as whether equity should in the particular case extend or restrict liability independently of causal (factual) connection. So far, only disparate factors, including emphasising the court's remedial discretion; fashioning an appropriate equitable allowance or imposing a cap on the duration on the order etc, have been suggested to qualify absolute disgorgement. It is submitted that in articulating relevant principles for a fiduciary's liability to account, a remoteness rule which delimits the boundaries of the award within the scope of liability for breach of fiduciary duty would be helpful.

In conclusion, although it would be difficult to achieve any mathematical exactness in attributing causal and legal responsibility, analytical tools such as causative tests and rules of remoteness are vital if the law is to be progressed on a rational basis.

